

THE INSTITUTIONAL FRAMEWORK

“All natural resources in the soil and the waters of the country are under the jurisdiction of the State and shall be used for the greatest benefit and welfare of the People.”

-Article 33, Indonesian Constitution

The Indonesian Parliament (Dewan Perwakilan Rakyat – DPR) passed the oil and gas bill into law on October 23, 2001. The new law replaces Oil and Gas Law No. 44/1960 and Law for Pertamina No. 8/1971. It reduces the government's power over the petroleum sector and allows for open competition in the downstream oil and gas distributing and marketing area. The new law authorizes the establishment of an implementation agency ("badan pelaksana") and regulatory agency ("badan peraturan") to assume state oil and gas company Pertamina's roles. The implementation agency has replaced Pertamina in managing Production Sharing Contract (PSCs) with private oil and gas companies, thus eliminating the conflict-of-interest inherent in upstream producer Pertamina regulating the activity of its competitors. The law also removed Pertamina's monopoly in the downstream sector with the regulatory agency assuming the responsibility for managing natural gas and domestic fuel distribution and supply.

The GOI generally met the law's stipulation that the two new agencies be established within one year of the law's enactment, and Pertamina establish itself as a limited liability company ("persero") within two years (see below). Pertamina

does maintain its overall responsibility for domestic fuel supply and distribution for four years after the law's enactment. Existing PSC's will be grandfathered and in effect until expiration of the contract. The GOI has issued three of five required implementing regulations under the law -- Pertamina's transition to a limited liability company, and the establishment of the implementing and regulatory agencies. As of the end of 2003, however, the government had not yet issued the remaining two implementing regulations, on the upstream and downstream sectors.

Article 33 of the Constitution still requires the government to continue its key role in the management of Indonesia's energy sector. All energy activities dealing with petroleum and gas fall under the Ministry of Energy and Mineral Resources, which is charged with creating and implementing Indonesia's energy policy. The Ministry of Energy and Mineral Resources is divided into several directorates, with the Directorate General of Oil and Gas (MIGAS) responsible for all aspects of the petroleum industry, including its development, employee training, and promulgating regulations.

BP Migas

On July 16, 2002, President Megawati signed Government Regulation No 42/2002, establishing a new Executive Board for oil and gas upstream operations as required by Oil and Gas Law No 22/2001. This upstream implementing body or Badan Pelaksana Minyak dan Gas Bumi (BP Migas) assumes the long role of Pertamina's regulatory functions and

responsibilities in managing oil and gas contractors.

BP Migas' main tasks and authorities are:

1) to provide recommendations to the Minister in preparing and offering work areas and cooperation contracts; 2) to sign cooperation contracts; 3) to control upstream business operations and 4) to appoint sellers of the government's share of oil and gas. The board is a non-profit state legal entity, acts on behalf of the government as party to the cooperation contract with business entities, but at the same time also acts as a board, which controls all oil and gas business operations.

Although BP Migas has been managing upstream regulatory activities since mid-2002, the government has not yet issued upstream implementing regulations in accordance with Oil and Gas Law 22/2001. Current and prospective upstream players hope the government will issue these regulations early in 2004 and that they will bring greater clarity to the sector.

BPHMigas

On December 30, 2002 President Megawati Sukarnoputri signed a Government Regulation (PP) No 67/2002 establishing a new downstream regulatory body, the Badan Pengatur Hilir Minyak dan Gas Bumi (BPH Migas), which assumes the role of Pertamina in controlling downstream activities. Among BPH Migas' responsibilities are regulating and determining the supply and distribution of oil-based fuel, regulating the transmission and distribution of natural gas, allocating fuel to meet national oil fuel reserves, the use of oil and gas

transportation and storage facilities, setting tariffs for gas pipeline use, setting the price of natural gas for household and small consumers and making recommendations on pipeline levies and setting the price of pipeline rights.

Despite this long list of responsibilities, the full scope of BPH Migas' activities requires clarification. Potential new downstream participants hope the government will provide this clarification in new downstream implementing regulations, which are expected in 2004.

BPH Migas is a smaller body than its upstream counterpart, BP Migas. BPH Migas consists of a committee of nine (one Chairman and eight members). Committee members are appointed by the President, based on the recommendation of the Minister of Energy and Mineral Resources and after approval by the House of Representatives (DPR). The Chairman must periodically report to the President (every six months or as requested), via the Energy Minister.

Pertamina

On June 18, 2003, President Megawati Sukarnoputri signed a government regulation (PP) No. 31/2003 regarding the transformation of state oil and gas company Pertamina into a limited liability company (Persero). The new regulation is in line with efforts to establish a new competitive and efficient entity, which is expected to increase economic activity and the welfare of the people.

Under the new regulation, all state assets in Pertamina as well as all assets of Pertamina including its subsidiaries and joint venture will serve as the capital of the new entity. The Minister of Finance

based on a joint evaluation by the Minister of Energy and Mineral Resources and the Minister of Finance will determine the amount of capital of the new entity. The new entity has authority from the government to supply fuel oils for domestic consumption, with compensation to be provided by the government. It also states that at the time of the establishment of the new entity, activity on geothermal businesses will be handed over to the new entity but within two years the entity has to establish a new subsidiary. A joint decree by the Minister of Finance, Minister of Energy and Mineral Resource and State Minister for State Owned Company will be issued in implementing the new regulation.

Pertamina significantly contributes to Indonesia's petroleum output. It ranks 9th in crude oil production and was Indonesia's 5th largest producer of natural gas in 2002. Pertamina executives have expressed their resolve to enhance Pertamina's position in the upstream sector to position the company for petroleum sector deregulation.

The company has planned a total investment of \$2.08 billion over five years. Two thirds of the investment will be in upstream business and the remainder in downstream. Pertamina needs funds to upgrade its aging refineries, LPG and fuel depots and distribution infrastructure, replace and supplement its old shipping fleet, and for upstream acquisitions.

Pertamina has seriously studied business prospects in Iraq even though its October 2002 exploration contract for Block 3, Western Desert was temporarily subject to force majeure in April 2003 due to the war in Iraq. Pertamina has an office in Baghdad, which is staffed on a rotating

basis. Pertamina is presently analyzing seismic data for its contract area and will not begin exploration activity until the validity of its contract with the new Iraq government is confirmed and the security situation improves. Pertamina plans to invest \$24 million over three years for the block, which has estimated oil reserves of 3 billion barrels of oil.

Government Agreements and Contracts

There are two categories of agreements and contracts for Indonesia's petroleum industry. The first category refers to the bundle of rights and obligations granted to an investor to invest in cooperation with the GOI in oil and gas exploration and exploitation. These types of contracts are the Production Sharing Contract (PSC), the Technical Assistance Contract (TAC), and the Enhanced Oil Recovery (EOR) contract, defined as follows:

Production Sharing Contracts:

- A cooperation contract for oil and gas exploration between BP Migas and a private investor (which includes foreign and domestic companies, as well as PT Pertamina);
- BP Migas is the supervisor or manager of the PSC;
- Investors are participating interest holders and Contractors;
- The government take is under a production sharing arrangement whereby the GOI and the Contractors take a split of the production measure in revenue based on PSC-agreed percentages;
- Operating costs are recovered from production through Contractor cost oil formulas as defined by the PSC;

- The Contractor has the right to take and separately dispose of its share of oil and gas;
- Title of the hydrocarbons passes to the Contractor at the export or delivery point.

Technical Assistance Contracts:

- Variation of a cooperation contract, or PSC;
- Typically used for established producing areas and therefore covers exploitation only;
- BP Migas is the supervisor or manager of the TAC;
- Operating costs are recovered from production;
- The Contractor does not typically share in all production;
- The TAC can cover both exploitation and exploration if it occurs in an area where the GOI has encouraged exploration;
- Per Oil and Gas Law 22/2001, existing TACs will not be extended.

Enhanced Oil Recovery:

- Variation of a cooperation contract, or PSC;
- Used for established producing fields with the intent of applying advanced technology to increase the recovery of hydrocarbons in the reservoirs;
- Pertamina is usually a participant, along with investors; collectively they are the Contractor;
- BP Migas is the supervisor and manager of the EOR;
- Operating costs are recovered from production and typically capped at a percentage. In some cases, the incremental oil lifted from an EOR operation may be

shared on a production sharing basis;

- In many cases, the EOR may also include provisions concerning how the parties will conduct petroleum operations.

In addition to contracts that give bundles of rights to explore and exploit, the participants in the PSC, TAC or EOR may also enter into separate agreements to discuss how they are going to conduct petroleum operations. These are known as Joint Operating Agreements (JOA) and Joint Operating Bodies (JOB), defined as follows:

Joint Operating Agreements:

- A separate agreement in addition to the cooperation contract;
- Governs the relations of the participating interest holders, defining their rights and obligations, and describing the procedures the Contractors will abide by;
- The JOA typically includes: 1) the scope of operations; 2) designation, rights and obligations of the operator; 3) establishment of an Operating Committee; 4) production disposition; 5) relinquishment, withdrawal and assignment; 6) confidentiality; 7) force majeure; and 8) dispute resolution and choice of law.

Joint Operating Bodies:

- Typically part of the JOA;
- Governs the operations on behalf of the participating interest holders by establishing a non-legal entity, the JOB, to conduct petroleum operations;

- Representatives of the participating interest parties appoint representatives to the JOB;
- The JOB prepares an operating work program and budgets and carries out operations pursuant to the JOB agreement and the cooperation contract;
- Participating interest holders remain the Contractors;
- JOAs are supervised by BP Migas.

Fiscal Decentralization Law

With implementation of a new fiscal decentralization law in January 2001, revenue-sharing formulas came into effect that directed 15 percent of the Indonesian Government's net oil revenues and 30 percent of its net natural gas revenues to provincial and district governments. The GOI's net oil and gas revenues refer to profit after cost recovery and deduction of the PSC share. Of the 15 percent of the oil revenue flowing to the regions, 6 percentage points will go to the regency of origin (where the PSC is located), 6 percentage points will be shared among the other districts in the province, and 3 percentage points will go to the provincial government. The same relative shares apply to gas revenues – 12 percent to the regency of origin, 12 percent among the remaining regencies and 6 percent to the provincial government.

OPEC

Indonesia joined OPEC in 1962 as active member and has hosted important OPEC conferences in 1964, 1976, 1980 and 1997. OPEC member countries meet at least twice a year to coordinate their production policies in light of market

fundamental. Organization of Petroleum Exporting Countries (OPEC) produce about 38 percent of the world's oil and 50 percent of the oil traded internationally. Indonesian Energy Minister Purnomo Yusgiantoro will assume the rotating OPEC presidency beginning January 1, 2004.

In an effort to control oil price volatility and to counter what they saw as softening crude oil prices, the latest Consultative Meeting of the Conference of the OPEC Oil Ministers in September 2003 agreed to cut production by 900,000 barrels per day to 24.5 million barrels per day, effective November 1, 2003. This was due to the gradual return of Iraqi crude to the world market and based on a forecast decline in oil demand in 2004. In addition, OPEC has also urged non-OPEC member countries (Angola, Mexico, Norway, Oman and Russian Federation) to cut oil production by 500,000 barrels per day. Previously OPEC increased production by 900,000 b/d effective June 2003 and Indonesia received a 47,000 b/d quota increase to 1.317 million b/d, although actual output is closer to 1 million b/d.

Country	OPEC Quota (Million B/D)				
	Sep 2001	Jan 2002	Jan 2003	Feb 2003	June 2003
S. Arabia	7,541	7,053	7,646	7,963	8,256
Iran	3,406	3,186	3,377	3,597	3,729
Venezuela	2,670	2,497	2,647	2,819	2,923
UAE	2,205	1,894	2,007	2,138	2,217
Kuwait	1,861	1,741	1,845	1,966	2,038
Nigeria	1,911	1,787	1,894	2,018	2,092
Libya	1,242	1,162	1,232	1,312	1,360
Indonesia	1,203	1,125	1,192	1,270	1,317
Iraq	N/A	N/A	N/A	N/A	N/A
Algeria	741	693	735	782	811
Qatar	601	562	596	635	658
TOTAL	23,201	21,700	23,000	24,500	25,400

Source: MIGAS

The Ministry of Energy and Mineral Resources said that Indonesia intends to

remain an OPEC member despite its falling net oil export volumes. As Indonesia finds it increasingly difficult to maintain a net exporter status, industry experts will continue to question whether the country will keep its OPEC membership.

Other Professional Bodies

IPA

The Indonesian Petroleum Association (IPA) was established in 1971 in response to growing foreign interest in the Indonesian oil sector. Contractors and the government meet frequently to discuss matters such as production ventures and energy economics. The IPA's objective is to use public information to promote the exploration, production, refining and marketing aspects of Indonesia's petroleum industry.

IGA

The Indonesian Gas Association (IGA) was established in 1980 under the sponsorship of Pertamina and key gas producers, Mobil and Huffco. The main objective of IGA is to provide a forum to discuss matters relating to natural gas and to advance knowledge, research and development in the areas of gas technology. IGA also aims to promote the development of infrastructure and cooperation among producing, transporting, consuming and regulatory segments of the gas industry.

The IGA and the IPA sponsored Indonesia's membership on the Permanent Council of the World Petroleum Congress (WPC).